

# Generalized System of Preferences Pre-Assessment Survey

## Internal Control Technical Guide

### Objective

Provide guidance in performing a Pre-Assessment Survey (PAS) of the company's internal control for Generalized System of Preferences (GSP) and evaluating the results.

### Background

Generally Accepted Government Auditing Standards require the PAS team to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing, and extent of tests to be performed.

The guidelines and the terms in this technical guide are based on *Assessing Internal Controls in Performance Audits*, GAO/OP-4.1.4, published by the United States General Accounting Office, Office of Policy, September 1990; and the American Institute of Certified Public Accountants *Statement on Auditing Standards No. 78*.

Title V of the Trade Act of 1974 (19 U.S.C. 2461-2465), as amended, which authorized the President to establish a GSP to provide duty-free treatment for eligible articles imported directly from designated beneficiary developing countries (BDCs).

The eligible BDCs are listed in General Note 4 of the Harmonized Tariff Schedule of the United States (HTSUS). General Notes 4(a) and 4(b) provide the list of BDCs, the combinations of BDCs treated as one country, and the least developed BDCs eligible for GSP treatment.

General Note 4(c) provides general exceptions by merchandise description to GSP, and 4(d) provides specific exceptions by specific BDC country and HTSUS number not eligible for GSP treatment.

Title 19 CFR 10.171 through 10.178 states the regulations for GSP.

GSP allows duty-free treatment for goods meeting certain eligibility requirements on entry into the United States. To qualify for GSP, goods must meet the following requirements:

- The imported goods must come to the United States directly from the GSP-eligible country; the direct shipment requirements are in 19 CFR 10.174 and 10.175.
- The imported goods must be wholly the growth, product, or manufacture of the BDC, or a new or different article of commerce that has been grown, produced, or manufactured in a BDC, as stated in 19 CFR 10.176 (a).
- The imported goods must meet the value content requirements of 19 CFR 10.176 through 10.178. GSP merchandise that is not wholly the growth, product, or manufacture of a BDC may be accorded duty-free treatment only if the direct costs of processing performed in the BDC plus the cost or value of materials produced in the BDC is not less than 35 percent of the appraised value.

Information can be requested from the producer using the table provided in 19 CFR 10.173(a)(1). The information requested shall be submitted within 60 days of the date of the request or such additional period as may be allowed for good cause shown.

GSP eligibility is reported using the letter A (the letter Q is used where GSP has expired with the possibility that privileges may be reinstated) in the Special Program Indicator column of the Automated Commercial System (ACS) database. Where an imported good is eligible for GSP, the letter A is also listed in special rates of duty part of Column 1 of the HTSUS. Where the

HTSUS indicates an A+ in the Column 1 special rates of duty, the duty-free rate applies only to the least developed BDCs listed in General Note 4(b). Where the special rates of duty part of Column 1 of the HTSUS indicates an A\* notation for a specific HTS number, certain BDCs listed in General Note 4(d) are not eligible for GSP for the designated HTS number.

Additional guidance is found in the publication “A Guide for Supporting Generalized System of Preferences (GSP) Claims” (FA Kit Exhibit 4F).

## Examples of Red Flags

The following examples are conditions that may indicate a potential problem in GSP.

- Company has insufficiently documented, poorly defined, or no internal control for accurately declaring GSP for Customs purposes. Examples:
  - ✓ Company does not monitor or interact with the broker on GSP issues.
  - ✓ Company relies on one employee to handle GSP issues, and there are poor or no management checks or balances over this employee.
- Company Customs staff lacks knowledge of GSP eligibility issues.
- Company offers unreasonable explanations to Customs.
- Company fails to cooperate or respond to Customs.
- Company has high turnover of people in key positions.
- Significant variance exists between the importer’s data and Customs data.
- Customs (import specialist, account manager, compliance measurement, prior audit) shows history of problems with GSP (e.g., GSP eligibility issues or reporting incorrect country of origin).
- One company representative dominates multiple phases of the GSP process without monitoring or management oversight.
- High compliance measurement error rates occur for HTSUS numbers that the company frequently uses regarding GSP.
- The company imports from a specific provider or under an HTSUS number or country of origin that have been identified by Customs because of known or suspected GSP problems.
- The company imports indicate a large number of GSP Manufacturer Identification (MIDs).
- The company imports a large quantity of GSP articles over many HTSUS numbers.
- The company does not monitor of the GSP classification or records process.
- The company imports of GSP increase significantly from a prior period.
- The importer and the GSP producer are related.
- GSP imports have not been previously audited or reviewed by Customs.
- Specific issues are identified in the profile.
- Company does not request, maintain, or review documents supporting the qualification of GSP (e.g., value content qualification).
- The company Imports some GSP articles that may be considered sets, mixtures, or composites (see T.D. 91-7 and HQ ruling 559010, dated 3/14/96) that could preclude GSP eligibility.
- The company imports some GSP articles which, in addition to a value content requirement, may require a “double substantial transformation” (see CSD 85-25, which explains 19 CFR 10.177(a)(2)).

- Value content qualification is marginal, just meeting the 35 percent requirement, increasing the importance of accurate cost computations.
- Direct materials alone are not adequate to meet the 35 percent value content requirement, making accurate direct processing costs particularly important.

### **Examples of Best Practices**

- Internal controls over GSP:
  - ✓ Are in writing,
  - ✓ Include procedures for monitoring and feedback, and
  - ✓ Are monitored by management.
- One manager is ultimately responsible for control of the Import Department, including GSP. That manager has knowledge of Customs matters and the power to ensure that internal control procedures for imports are established and followed by all company departments.
- Written internal control procedures assign GSP duties and tasks to a position rather than a person.
- Company has good interdepartmental communication about GSP matters.
- Company conducts and documents periodic reviews of GSP, and uses the results to make corrections past and present to entries and changes to its import operations as appropriate.
- Purchasing, Engineering, other departments and suppliers provide sufficient descriptions of merchandise to permit a determination of GSP eligibility.
- Internal control includes a verification process to determine that the imported merchandise qualifies for GSP.
- Importer has procedures to obtain any required or necessary documentation to support the claim (e.g., a penalty provision on suppliers if GSP information is not provided to Customs on demand).
- Importer maintains a GSP database or listing of imported merchandise that would readily identify GSP transactions
- The importer (or the importer's agent) visits the plant in the GSP country where the products are produced.
- The importer performs an annual review of changes to GSP.

### **Examples of Documents and Information to Review**

- Internal control policies and procedures for ensuring proper GSP eligibility
- Company's response to the questionnaire
- Interviews with company staff concerning general internal control and internal control specific to GSP
- Company's documentation that supports monitoring and verification of established and/or written internal control for GSP, including:
  - ✓ GSP declaration signed by the person responsible for certifying that all information on the documentation is accurate and complete
  - ✓ If available from the importer, the GSP costing sheet
  - ✓ Binding rulings concerning GSP
  - ✓ Invoices, specification sheets, or other documents providing detailed descriptions of GSP merchandise
  - ✓ List containing GSP part numbers, descriptions, quantities imported, and unit costs

- ✓ Bills of lading or other evidence of direct transport to the United States
- ✓ Producer's written attestation that goods are wholly the growth or product of a BDC
- ✓ Records from the GSP producer supporting the company's verification for goods not wholly the growth or product of a BDC, such as GSP cost allocation worksheets, bills of materials, product specification sheets, engineering drawings, work-in-process documents, material inventory records, purchase history reports, and/or material supplier lists

## Suggested Testing

PAS team judgment should be used to determine the type and amount of testing needed to evaluate how effective internal control is and whether there is sufficient risk to warrant proceeding to the Assessment Compliance Testing (ACT) process.

Using the chart and guidelines below, determine through limited judgmental testing whether the company's internal control is effective.

To determine the extensiveness of internal control testing, it is necessary to evaluate:

1. The **risk exposure**, and
2. The **internal control** system by determining if the controls are in operation, how the controls were applied, how consistently they were applied, and who applied them.

## Risk Exposure

Risk exposure is the probability of significant Customs noncompliance. In each step of determining risk exposure, consideration should be given to:

1. Significance (to Customs) and sensitivity (e.g., issues of interest to Congress or the media, or affecting admissibility)
2. Susceptibility (of making incorrect declarations)
3. The existence of any red flags
4. Management support (of strong internal control)
5. Competent personnel (to adequately administer the controls)

### *Steps to Determine Risk Exposure:*

1. Evaluate problems identified in the profile, compliance measurement rates, questionnaire, and concerns raised by the import specialist and account manager.
2. Perform the macro risk analysis tests.
3. Analyze the macro risk analysis tests results to determine the risk exposure level.
4. Evaluation of risk exposure is not simply a one-time process that occurs at the start of the PAS process. Continually reassess risk exposure as more information is gathered from evaluating internal control and performing other work in the PAS.

## Macro Risk Analysis Examples

### *Example A: Low Risk Exposure*

The import specialist, the account manager, and the profile did not identify any concerns with this importer's GSP program. The importer stated that all GSP came from one manufacturer. The same GSP merchandise from that manufacturer had been evaluated and accepted by a Focused Assessment team the previous year. The PAS team compared the total GSP merchandise value reported in ACS to the importer's payments to the manufacturer for the same audit period. The comparison showed ACS to approximate the total payments to the manufacturer. Because there were no PAS team concerns and the importer's GSP data mirrored Customs' ACS data, the risk exposure level was considered low.

### *Example B: High Risk Exposure*

The import specialist, the account manager, and the profile identified specific concerns with this importer's GSP program. GSP merchandise was frequently misclassified and was sometimes not eligible for GSP when it was correctly classified. The company was the 10<sup>th</sup> largest importer of GSP. For the year of audit, the importer stated that all GSP came from 10 manufacturers. The PAS team compared the total GSP merchandise value reported in ACS to the importer's payments to the manufacturers for the same audit period. The comparison showed ACS to be significantly lower than the total payments to the manufacturers. Because non-GSP data could be incorrectly listed as GSP, the risk exposure level was considered high.

## System of Internal Control

To evaluate the internal control system:

1. Consider the five components of internal control:
  - Control Environment
  - Risk Assessment
  - Control Activities
  - Information and Communication
  - Monitoring
2. Review relevant Customs and company documents to identify and understand relevant internal control over GSP. (Examples of documents and information to review are listed above.)
3. Determine whether the company has established and follows procedures. Review:
  - Documentary evidence of the results of periodic internal control reviews/testing and corrective action implemented.
  - Documentary evidence (such as a log) of communication with the broker and company departments on GSP issues, including company testing of broker operations and verification that the broker followed company instructions.
  - Company-specific GSP rulings requested. Determine if they are followed.

- Documentary evidence of intercompany communications, to ensure that correct information is provided to Customs.
  - Training records and materials relating to GSP used to educate staff on Customs matters.
4. Review written policies and procedures and interview applicable company personnel to complete appropriate sections of the "Worksheet for Evaluating Internal Control Over Generalized system of Preferences (GSP)."

Note: The internal control assessment should include steps to:

- Identify and understand internal control
- Determine what is already known about control effectiveness
- Assess the adequacy of internal control design
- Determine whether controls are implemented and effective
- Determine whether transaction processes are documented

### Extensiveness of Audit Tests (Testing Limit)

The purpose of limited PAS testing is to take a survey in order to determine the necessity for and extent of substantive tests. In some circumstances, the PAS team may decide that it probably will not be able to form an opinion based on limited PAS testing. In that case, it may be necessary to proceed immediately to the ACT process. If the PAS team believes that it can form an opinion based on limited PAS testing, test the appropriate number of controls and associated transactions using the table below. Tests may be appropriate for various areas below the total GSP level that compliance will be reported on. For example, the company may import from several foreign companies, but testing may be necessary only for certain companies or only for certain imports that have been identified as the primary risks.

#### Determining Extensiveness of Audit Tests

Risk Exposure	+	Preliminary Review/ Internal Control	=	Extensiveness of Audit Test	Testing Limit
<b>High</b>		Weak Adequate Strong		High Moderate to High Low to Moderate	10-20
<b>Moderate</b>		Weak Adequate Strong		Moderate to High Moderate Low	5-15
<b>Low</b>		Weak Adequate Strong		Low to Moderate Low Very Low	1-10

Source: Adapted from *Assessing Internal Controls in Performance Audits*.  
Column titled "Testing Limit" reflects Customs test sizes.

### Evaluation of Pre-Assessment Survey Testing Results

The following steps are guidance for determining the effectiveness of company's internal control over GSP.

1. Complete the "Worksheet for Evaluating Internal Control Over Generalized System of Preferences (GSP)" to determine whether risk determination is acceptable or unacceptable and document why. Put results of GSP testing in perspective and evaluate confirmed weakness as a whole. The evaluation should consider the results of the internal control testing, problems identified in the profile, and/or concerns raised by the import specialist or account manager. The team must evaluate the PAS results based on the specific situations.  
Customs considers risk unacceptable when testing reveals that internal control was not sufficient or effective in providing reasonable assurance that accurate, timely, and complete declarations are reported to Customs.
2. The following will assist the PAS team in determining whether conditions warrant proceeding to ACT:
  - **Do not proceed to ACT (Revenue) if:**
    - ✓ Cost-benefit analysis warrants no further effort (do not spend a significant amount of resources to identify a potential loss of revenue considered insignificant).
    - ✓ The PAS indicated that the GSP revenue loss was due to an isolated incident.
    - ✓ The company agrees with the PAS finding(s) and agrees to quantify the GSP actual loss of revenue within an acceptable time frame.
  - **Do not proceed to ACT (Compliance) if:**
    - ✓ An incorrect GSP eligibility issue was isolated and the importer can show identical entry lines with the GSP correctly reported.
    - ✓ The GSP eligibility errors were systemic and the importer agrees to develop and implement a Compliance Improvement Plan within an acceptable time frame.
  - **Proceed to ACT (Revenue) if:**
    - ✓ Company does not have adequate internal control, and the PAS indicated a material loss of revenue that cannot be quantified without statistical sampling, or further review.
    - ✓ Importer will not quantify loss of revenue.
  - **Proceed to ACT (Compliance) if:**
    - ✓ The company refuses to take corrective action on systemic errors, and it is necessary to calculate a compliance rate.

Note: If substantive tests necessary to determine a compliance rate or revenue loss can be quickly performed without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

3. Determine whether referrals should be made for enforcement action.

### Examples

The following examples of situations might be encountered under PAS are *for clarification purposes only*.

*Example A: Situation in which the team would not proceed to ACT (Revenue)*

The importer has internal control for GSP. The internal control includes contract provisions in which the exporter agrees to provide documentary support for GSP eligibility to Customs on demand; reviews of foreign facilities to verify foreign production in the BDC; and maintenance of documentary information to support importer reviews and testing of GSP eligibility. In order to determine the importer's internal control effectiveness, the PAS team evaluated the importer's internal control procedures. Specifically, tests of GSP eligibility data, including cost data, supported the eligibility of products from all GSP manufacturers except Happy Link. The team concluded that internal control was effective for shipments of all manufacturers except Happy Link. The breakdown in internal control was systemic. The importer had not included the GSP contract provisions in the contract negotiated with Happy Link. When Customs, as part of the limited testing for GSP, required that Happy Link provide support for GSP eligibility for the items sampled, the manufacturer refused. The entries were not liquidated. The importer agreed to quantify and pay the lost revenue on the Happy Link imports and change its internal control procedures. All future contracts will be amended to include GSP requirements *before* merchandise is declared as eligible for GSP. Since there were no other revenue issues and correction was made to avoid future problems, the team does not proceed to ACT for revenue.

*Example B: Situation in which the team would not proceed to ACT (Compliance)*

Same as example A above, except that the importer agrees to amend the contract with Happy Link to include the GSP provisions immediately, and Happy Link sends the requested country of origin information to Customs. Since the importer agreed to correct internal control deficiencies and Happy Link's merchandise was determined to be GSP eligible, there is no reason to proceed to ACT for compliance.

*Example C: Situation in which the team would proceed to ACT (Revenue)*

Same as example B above, except that preliminary analysis indicates that for some imports, Happy Link provided the data required by the controls; thus, some of the imports from Happy Link may qualify for GSP (and others do not). Imports from Happy Link included a large volume of low-value items. The importer is unable to quantify the GSP-eligible value in the Happy Link account. The PAS team proceeds to ACT to use statistical sampling to project revenue loss.

*Example D: Situation in which the team would proceed to ACT (Compliance)*

the same as example C above, except that preliminary analysis indicates that some of the imports from Happy Link may qualify for GSP. The importer agrees to pay duty on imports for the one Happy Link contract found during the PAS as outside GSP internal control. The importer does not want to change its current internal control and believes that it meets an acceptable level of compliance for GSP (i.e., importer indicates that the internal control breakdown was an isolated event). Since the importer will not change its internal control and the level of compliance is unknown, the PAS team proceeds to ACT to determine whether the importer meets the acceptable level of compliance for GSP.



## Worksheet for Evaluating Internal Control Over Generalized System of Preferences (GSP)

**OBJECTIVE:** Determine whether the company has procedures designed to effectively control Customs risks related to merchandise entered under provision of GSP.

**Risk Determination:**

**Acceptable** \_\_\_\_\_

**Unacceptable** \_\_\_\_\_

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
<b>Overall Controls</b>						
Are internal controls over GSP formally documented?						
Are written policies and procedures approved by management?						
Are written policies and procedures reviewed and updated periodically?						
Is one manager is responsible for control of the Import Department, including GSP?						
Does that manager have knowledge of Customs matters and the authority to ensure that internal control procedures for imports are established and followed by all company departments?						
Does the responsible person have cost accounting knowledge?						
Do written internal control procedures assign GSP duties and tasks to a position rather than a person?						

Does company have good interdepartmental communication about GSP matters?						
Does company conduct and document periodic reviews of GSP?						
Does company use the GSP periodic review results to make corrections to past and present entries?						
Does company use the GSP periodic reviews to make changes to its import operations as appropriate?						
Do internal controls involve a verification process to determine that the imported merchandise qualifies for GSP?						
Is adequate descriptive information provided (by Purchasing, Engineering, other departments, and suppliers) to the Customs Department and/or broker to ensure proper GSP classification and eligibility?						
Does the importer have procedures to obtain any required or necessary documentation to support the claim (e.g., a contract penalty provision if GSP information is not provided to Customs on demand)?						
Does the importer maintain a GSP database or listing of imported merchandise that would readily identify GSP transactions?						
Does the importer (or the importer's agent) visit the plant in the GSP country where the products are produced?						
Does the company perform an annual review of changes to GSP?						

<b>New GSP Merchandise</b>						
Does management review the classification and eligibility of new GSP items?						
Is responsibility for the GSP eligibility process assigned to one knowledgeable individual or department with management oversight?						
Is adequate descriptive information provided to the Customs Department and/or broker by suppliers, engineers, Purchasing Department, etc., to ensure proper classification?						
Is Customs assistance sought in classifying merchandise (e.g., requesting binding rulings)?						
<b>Entry Review</b>						
Does the company review entries to verify that correct classifications were used?						
Does the company monitor the entry review process to verify that controls were followed?						
Are suppliers required to print company-provided HTSUSs on invoices and/or packing lists?						
Does the individual reviewing merchandise have adequate knowledge of and training on GSP issues?						
<b>Broker Oversight</b>						
Are HTS classifications for GSP maintained in a database that is provided to brokers?						
Are brokers required to have written company approval to make						

classification changes?						
Does the company provide adequate broker oversight?						
<b>IC Conclusions</b>						
Did PAS testing support control procedures?						
Do interviews with responsible persons support control procedures?						
Does the company have internal control to address specific issues identified in the profile?						
<b>List Company-Specific Procedures Below (if applicable)</b>						